

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 98-362-W/S – ORDER NO. 1999-126
FEBRUARY 19, 1999

IN RE: Application of River Pines Water Systems, Inc. for)	ORDER
Approval Of an Increase in Its Water and Sewer Rates)	APPROVING
And Charges)	RATES AND
)	CHARGES

This matter comes before the Public Service Commission of South Carolina (the Commission) by way of Application of River Pines Water Systems, Inc. (River Pines or the Company) for approval of a new schedule of rates and charges for water and wastewater rates and services provided to its customers in South Carolina. The Company's August 25, 1998 Application was filed pursuant to S. C. Code Ann. § 58-5-240 (1976), as amended, and 26 S.C. Regs. 103-821 (1976), as amended.

By letter, the Commission's Executive Director instructed the Company to publish a prepared Notice of Filing, one time, in a newspaper of general circulation in the area affected by the Company's Application. The Notice of Filing indicated the nature of the Company's Application and advised all interested parties of the manner and time in which to file appropriate pleadings. Additionally, the Company was instructed to directly notify all of its customers affected by the proposed increase. The Company submitted affidavits

indicating that it had complied with these instructions. A Petition to Intervene was filed by the Consumer Advocate for the State of South Carolina (the Consumer Advocate).

The Commission Staff made on-site investigations of the Company's water and sewerage systems, audited the Company's books and records, and gathered other detailed information concerning the Company's operations.

On December 9, 1998, a public hearing concerning the matters asserted in the Company's Application was held in the Commission's Hearing Room. Pursuant to S. C. Code Ann. §58-3-95 (Supp. 1997), a panel of three Commissioners, composed of Commissioners Bradley, Carruth and Moseley was designated to hear and rule on this matter. Commission Chairman Bradley presided.

Elliott F. Elam, Jr., Esquire, represented the Consumer Advocate and F. David Butler, General Counsel, represented the Commission Staff.

The Company presented the direct testimony of James D. Hix, President of the Company, and Larry D. French, a certified public accountant of Rock Hill, South Carolina. The Consumer Advocate presented the testimony of Michael A. Bleiweis of The Woodside Group, Inc., Stamford, Connecticut, who analyzed the Company's Application and revenue requirements. The Commission Staff presented the testimony of Charles A. Creech, Associate Engineer, Utilities Department, and Steve W. Gunter, Accountant/Fiscal Analyst, Accounting Department.

Upon full consideration of the Company's Application, the evidence presented at the hearing, and the applicable law, the Commission makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. River Pines Water Systems, Inc., is a water and sewer utility operating in the State of South Carolina and is subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. § 58-5-10 (1976) et seq. Application of Company; Hix testimony.

2. The Company operates three systems: a water system serving 70 residential customers in the River Pines subdivision, just outside the Rock Hill, South Carolina city limits; a water system serving 131 customers in the Wood Forest subdivision, also just outside the Rock Hill, South Carolina city limits; and a sewer system serving 104 customers in the Wood Forest subdivision, all described properties being located in York County, South Carolina. Application of Company; French testimony.

3. River Pines Water System, Inc.'s present water and sewer rates and charges were approved by Order No. 88-335, issued in Docket No. 87-407-W/S, on March 30, 1988.

4. Under present rates, a customer in River Pines subdivision, using an average monthly consumption of 6,758 gallons would pay \$13.80.

5. The presently approved water reconnect fee for both subdivisions is \$25.00. The Company did not propose a change for this fee. The Commission makes no finding in that regard.

6. The Company is seeking a proposed rate for water for River Pines subdivision of a monthly base charge of \$6.00 plus \$1.98 per 1000 gallons for all water used. Using the same average monthly consumption of 6,758 gallons at a present cost of \$13.80 and

the proposed rate, that same customer's bill would be \$19.38, which is a \$5.58 or 40.43% increase.

7. At present rates, a customer in Wood Forest subdivision, using an average monthly consumption of 8,660 gallons would pay \$17.04.

8. The proposed rate for water for Wood Forest subdivision is a monthly base charge of \$6.00 plus \$2.43 per 1000 gallons for all water used. Under the present rates, if the average monthly consumption for a Wood Forest subdivision resident was 8,660 gallons, the bill would be \$17.40. Using the requested rate, and an average monthly consumption of 8,660 gallons, the average monthly bill would be \$27.04, for an increase of \$9.64, a 55.40% increase.

9. The rate per 1000 gallons for Wood Forest subdivision would be different because the Company would be required to purchase this water from the City of Rock Hill at a rate of \$14.11 base charge plus \$2.01/1000 gallons. Supplemental testimony of Hix.

10. The schedule of present rates for sewer for the Wood Forest subdivision is \$16.10. The proposed rate schedule for sewer for the Wood Forest subdivision is \$21.50, an increase of \$5.40 or a 33.54% increase.

11. A main well serving Wood Forest subdivision became inoperable in 1997 as a result of a cave in and had to be abandoned. The Company then contracted to purchase wholesale water on an "as needed" basis from the city of Rock Hill until March 1, 1999 to serve Wood Forest customers. The Company has been purchasing that water for a flat

fee of \$14.11 base charge per month plus \$2.01/1000 gallons, the regular outside city rate. Hix supplemental testimony.

12. The Company plans to take the five wells that service the Wood Forest subdivision out of service because the water for that subdivision will be purchased from the City of Rock Hill. Hix testimony.

13. The Company asserts five reasons for this request for a rate increase. According to testimony by French, the Company's expenses have increased across the board. French explained that the Company has incurred increased operational expenses due to the need (1) to purchase water from the City of Rock Hill for the Wood Forest subdivision; (2) the increased maintenance costs due to the age of the River Pines Water system; (3) the ever-increasing costs of maintenance for the Wood Forest sewer plant; (4) the normal costs of operations including electricity to operate the sewer plant and the wells; and (5) an increase in the cost of chemicals for testing required by the South Carolina Department of Health and Environmental Control which have been increasing more than five per cent per year. Testimony by French.

14. The appropriate test period for the purposes of this proceeding is the twelve-month period ending October 31, 1997.

15. Under the Company's presently approved rates, the Company's operating revenues for the test year after accounting and pro forma adjustments are \$61,157. See Accounting Exhibit A. The Company seeks an increase in its rates and charges for water and sewer services in a manner which would increase its operating expenses by \$2,330. See Accounting Exhibit A.

16. The Company's total operating expenses, under its presently approved rates, for the test year after accounting and pro forma adjustments, for the combined water and sewer operations, is \$72,814. See Accounting Exhibit A.

17. The Commission will use the operating margin as a guide in determining the lawfulness of the Company's proposed rates and the fixing of just and reasonable rates.

18. A fair operating margin that the Company should have the opportunity to earn is 11.56% which is produced by the appropriate level of revenues and expenses found reasonable and approved herein.

19. The rate designs and rate schedules approved by the Commission as described herein are appropriate and should be adopted.

20. The rates and charges depicted in Appendix A, attached herein, and incorporated by reference, are approved and effective for service rendered on and after the date of this Order.

CONCLUSIONS OF LAW

1. The Company is a water and sewer utility providing water and sewer service in its service area in South Carolina. The Company's operations in South Carolina are subject to the jurisdiction of the Commission pursuant to S. C. Code Ann. §58-5-10 et seq. (1976) as amended.

2. A fundamental principle of the ratemaking process is the establishment of an historical test year with the basis for calculating a utility's rate base and, consequently, the validity of the utility's requested rate increase. While the Commission considers a

utility's proposed rate increase based upon occurrences within the test year, the Commission will also consider adjustments for any known and measurable out-of-test year charges and expenses, revenues, and investments, and will also consider adjustments for any unusual situations which occurred in the test year. See Southern Bell Telephone & Telegraph Company v. The Public Service Commission of South Carolina, 270 S.C. 590, 244 S.E.2d 278 (1978).

3. The Company chose the test year ending October 31, 1997. The Commission Staff used the same test year in calculating its adjustments. The Commission is of the opinion that the test year ending October 31, 1997 is appropriate for the purposes of this rate request based on the information available to the Commission.

4. The Commission concludes that the Staff's adjustments to the Company's operating revenues are appropriate. The Staff's adjustments recognize the annual level of revenues based on a billing analysis performed by the Company and audited by the Staff. Accordingly, the Commission finds that the appropriate level of revenues for the Company for the test year under the present rates and after accounting and pro forma adjustments is \$61,157.

5. The Commission adopted the Staff's accounting and pro forma adjustments to test year expenses which eliminated nonoperating revenues and expenses of testing fees for the South Carolina Department of Health and Environmental Control (DHEC). The South Carolina General Assembly allows the costs associated with testing fees required by DHEC to be passed through to customers. In addition, the Commission adopted Staff's adjustments to revenues for the number of billing units in the Wood Forest subdivision

because the Staff determined, after auditing the Company's books and records, that the number of sewer bills rendered by the Company exceeded the number stated in the Company's application.

6. The Commission also concludes that the Staff's adjustments to the Company's operating expenses are appropriate. Accordingly, the Commission concludes that the Company's appropriate operating expenses for the test year, after pro forma adjustments, is \$72,814.

7. The Commission adopted the Staff's adjustments to reduce the expense (\$1,900) of contracted maintenance to reflect the purchase of water from the City of Rock Hill, to increase the expense for purchased water to reflect the purchase of water from the City of Rock Hill for the Wood Forest subdivision, and to reduce the expense for purchased power to reflect the purchase of water from the City of Rock Hill for the Wood Forest subdivision. The Company will be required to purchase water for the Wood Forest subdivision because the five wells that currently serve that subdivision will be removed from service and the Company will be purchasing water from the City of Rock Hill, therefore eliminating maintenance to those five old wells.

8. The Company requested approval by the Commission of the agreement made September 15, 1998 between the City of Rock Hill and the River Pines Water System, Inc. for the provision of water by the City of Rock Hill to the Wood Forest subdivision. The Commission grants the approval of the contract.

9. The Consumer Advocate took the position through the testimony of witness Bleiweis that the pro forma test year should include a level of expenses that would be

representative of future periods. Bleiweis testified that this could be best accomplished by amortizing maintenance expense for River Pines-Water and Wood Forest-Sewer over a five-year period. The Commission took notice of witness Bleiweis testimony that the utility system is an old system. Due to the age of the system, it is the Commission's opinion that the costs to keep the system maintained will be increasing in the future. The Commission feels that using a five-year amortization would unfairly penalize the Utility in the setting of its rates. Taking into consideration the age of the utility system and the future cost to maintain the system, it is the Commission's opinion that maintenance expenses will be increasing in the future and that by using a five-year amortization, as suggested by witness Bleiweis, these increased expenditures would not be recognized. Due to this, the Commission rejects witness Bleiweis' five-year amortization in setting the rates for the Utility in this proceeding.

10. The Consumer Advocate brought up the issue of income taxes having been excluded as an expense by the Company but included as an expense adjustment by the Staff. Staff witness Gunter, Accountant/Fiscal Analyst, testified that the Commission has adopted the method of calculating income taxes as if the Company is a regular taxable corporate entity. Gunter further testified since the Utility is a Sub-Chapter S corporation, the owners would pay any taxes generated. He also stated there is no line item on a Sub-Chapter S income tax return for income tax expense. Gunter testified that the net operating income from Sub-Chapter S corporations is allocated to the shareholders, who then would report such income on their personal tax return. This allocated income

associated with a Sub-Chapter S corporation would then be taxed at the shareholder's tax rate. The Commission adopts the Staff's income tax adjustment as an expense.

11. The Commission concludes that after pro forma and accounting adjustments, the Company's test year operating revenues, operating expenses, and net income (loss) for return for its system were \$61,157, \$72,814, and (\$11,657) respectively. These figures are reflected in Table A as follows:

TABLE A
NET INCOME FOR RETURN

BEFORE RATE INCREASE

Operating Revenues	\$ 61,157
Operating Expenses	<u>72,814</u>
Net Operating Income	(11,657)
Customer Growth	<u>0</u>
Total Income for Return	<u><u>\$(11,657)</u></u>

12. Under the guidelines established in the decisions of Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), and Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944), this Commission does not ensure through regulation that a utility will produce net revenues. As the United States Supreme Court noted in Hope, a utility "has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures." However, employing fair and enlightened judgment and giving consideration to all relevant facts, the Commission should establish rates which will produce revenues "sufficient to assure confidence in the financial soundness

of the utility...that are adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." Bluefield, supra, at 692-693.

13. There is no statutory authority prescribing the method which this Commission must utilize to determine the lawfulness of the rate of a public utility. For a water utility whose rate base has been substantially reduced by customer donations, tap fees, contributions in aid of construction, and book value in excess of investment, the Commission may decide to use the "operating ratio" and/or "operating margin" method for determining just and reasonable rates. The operating ratio is the percentage obtained by dividing total operating expenses by operating revenues; the operating margin is determined by dividing the total operating income for return by the total operating revenues of the utility.

14. The Commission carefully considered the rate making methodology proposed by the Consumer Advocate's witness Bleiweis. Bleiweis suggested the Commission use the rate making methodology used by the Florida Public Service Commission as a guideline for South Carolina. The Florida methodology uses rate base return rather than operating margin as a basis for determining rates, creating a generic rate of return regardless of the size of the Company. The Commission finds the proposed rate making guideline to be an idea with merit, worthy of further study and investigation. However, the Commission declines to adopt that methodology at this time due to the need for further study and investigation. It is within the Commission's discretion to adopt the rate-setting method it believes is appropriate, provided that method complies with the statutes.

See Heater of Seabrook, Inc., 324 S.C. at 64, 478 S.E.2d at 830 (PSC generally has wide latitude to determine an appropriate rate-setting methodology).

15. The Commission concludes that use of the operating margin is appropriate in this case. Based on the Company's gross revenues, operating expenses, and customer growth for the test year, the Company's present operating margin for combined operations is as follows:

TABLE B
OPERATING MARGIN

BEFORE RATE INCREASE	
Operating Revenues	\$ 61,157
Operating Expenses	<u>72,814</u>
Net Operating Income	(11,657)
Customer Growth	<u>0</u>
Total Income for Return	<u>\$(11,657)</u>
Operating Margin	<u>-19.06%</u>

16. The Commission is mindful of the standard delineated in the Bluefield decision and of the need to balance the respective interests of the Company and of the consumer. It is incumbent upon this Commission to consider not only the revenue requirement of the Company but also the proposed price for the water and sewer treatment, the quality of the water and sewer service, and the effect of the proposed rates upon the consumers. See Seabrook Island Property Owners Association v. South Carolina Public Service Commission, 401 S.E. 2d 672 (1991); S.C.Code Ann. § 58-5-290 (1976), as amended.

17. The fundamental criteria of a sound rate structure have been characterized as follows:

...(a)the revenue-requirement or financial-need objective, which takes the form of a fair-return standard with respect to private utility companies; (b) the fair-cost apportionment objective which invokes the principle that the burden of meeting total revenue requirements must be distributed fairly among the beneficiaries of the service; and (c) the optimum-use or consumer rationing under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is economically justified in view of the relationships between costs incurred and benefits received.

Bonbright, Principles of Public Utility Rates (1961), p. 292.

18. Based on the considerations enunciated in Bluefield and Seabrook Island, and on the fundamental criteria of a sound rate structure as stated in Principles of Public Utility Rates, the Commission determines that the Company should have the opportunity to earn a 11.56% operating margin because of the Commission's determination of appropriate operating revenue and expenses. In order to have a reasonable opportunity to earn an 11.56% operating margin, the Company will need to produce \$84,917 in total annual operating revenues.

TABLE C
OPERATING MARGIN

AFTER RATE INCREASE

Operating Revenues	\$ 84,917
Operating Expenses	<u>75,144</u>
Net Operating Income	9,773
Customer Growth	<u>44</u>
Total Income for Return	<u>\$ 9,817</u>
Operating Margin	<u>11.56%</u>

19. In fashioning rates to give the Company the required amount of operating revenues so that it will have the opportunity to achieve an 11.56% operating margin, the Commission has carefully considered the concerns of the Company's customers as well as the interests of the utility. The Commission hereby approves the rates and charges as stated in this Order and attached hereto as Appendix A as being just and reasonable.

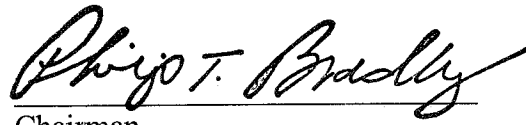
20. Accordingly, it is ordered that the rates and charges attached on Appendix A are hereby approved for service rendered on or after the date of this Order. The rate schedule is hereby deemed to be filed with the Commission pursuant to S.C. Code Ann. §58-5-240 (1976), as amended.

21. It is ordered that if the approved schedule is not placed in effect within three (3) months after the date of this Order, the approved schedule shall not be changed without written permission of the Commission.

22. It is further ordered that the Company maintain its books and records for water operations in accordance with the NARUC Uniform System of Accounts for water and sewer utilities as adopted by this Commission.

23. That this Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:


Chairman

ATTEST:


Executive Director

(SEAL)

River Pines Water System, Inc.
P.O. BOX 2585
Rock Hill, SC 29731
(843) 329-0408

Docket No. 98-362-W/S
Order No. 1999-126
Date: 2/19/99

Water

River Pines Subdivision

Base Charge - \$6.00 plus \$1.98 per 1000 gallons for all gallons used.

Wood Forest Subdivision

Base Charge - \$6.00 plus \$2.43 per 1000 gallons for all gallons used.

Sewer

Flat Rate - \$21.50

Reconnect Fee

Each Connection - \$25.00